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Berlin, 25 June 2010

Dear Françoise,

EFRAG's Draft Comment Letter on the Exposure Draft ED/2010/2 'Conceptual Framework Financial Reporting: The Reporting Entity'

On behalf of the German Accounting Standards Board (GASB), I am writing to comment on EFRAG's draft comment letter on the IASB on the Exposure Draft ED/2010/2 'Conceptual Framework Financial Reporting: The Reporting Entity'. We appreciate the opportunity to comment on EFRAG's draft comment letter.

The GASB agrees with the points raised by EFRAG in its draft comment letter.

Please find attached our **draft** comment letter to the IASB. We will send you the final version as soon as possible.

If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President



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Sir David Tweedie
Chairman of the
International Accounting Standards Board
30 Cannon Street

Berlin, 25 June 2010

London EC4M 6XH
United Kingdom

Dear David,

Exposure Draft ED/2010/2 'Conceptual Framework Financial Reporting: The Reporting Entity'

On behalf of the German Accounting Standards Board (GASB), I am writing to comment on the IASB Exposure Draft ED/2010/2 'Conceptual Framework for Financial Reporting: The Reporting Entity' (herein referred to as 'ED'). We appreciate the opportunity to comment on the ED and have provided our detailed responses to the questions contained in the ED in Appendix A to this letter. Appendix B contains some additional comments on other types of financial statements. However, we would like to start off with some general remarks and by expressing some key concerns.

The existing conceptual framework does not contain any concept of a reporting entity. Since we believe that underlying principle-based assumptions on the substance of an entity preparing general purpose financial statements are desirable, we welcome the efforts to develop a concept of a reporting entity for inclusion in the conceptual framework.



However, we think the usefulness of the proposed concept of a reporting entity remains vague. Additional information about the reasons underlying the concept should be given. It should be more prominently explained how the concept may be used in developing standards so that the relevance of the reporting entity concept becomes apparent.

Overall, we are concerned that the IASB concludes on matters that we firmly believe should rest solely with national legislators or regulatory authorities. In particular, we are worried that financial statements of particular entities will not be allowed to be labelled as 'having been prepared under IFRSs' because they do not comply with the description of a reporting entity. In our view, there should be no interference with the decision of national legislators or regulatory authorities made as to who is required to prepare financial statements as well as to what kind of financial statements are required to be prepared, e.g. consolidated or separate financial statements.

Furthermore, we believe that all legal entities should qualify as reporting entities, irrespective whether a legal entity represents a controlling entity or not and that separate financial statements should be treated as independent and autonomous. Appropriate caption and note disclosure should serve to sufficiently protect users from misunderstanding the substance and nature of the information included.

As it is up to national legislative bodies or regulatory authorities whether the application of IFRS is required or allowed by particular entities – even if the resulting financial statements may not be consistent with the idea the IASB had in mind when setting IFRS accounting rules – the IASB should make clear that the description of a reporting entity within the conceptual framework is simply a general orientation that assists the IASB in the development of International Financial Reporting Standards.

Contrary to the discussion paper, the ED does not clearly articulate the perspective of presenting (consolidated) financial statements. We consider a thorough discussion of this subject within the reporting entity chapter to be crucial. Previous discussions (e.g. within the project 'Business Combinations') as well as the academic literature (e.g. Baxter/Spinney, 1975) have already made clear that different views and diverse interpretations exist (such as the proprietary perspective, entity perspective or economic



unit concept, parent company and parent company extension approach). Therefore, any final chapter on the reporting entity should provide a principal-based frame dealing with this fundamental issue. We encourage the IASB to reconsider its decision to not address this issue in the final chapter.

If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr

President

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Appendix A: Answers to the questions of the Exposure Draft

Question 1

Do you agree that a reporting entity is a circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders and other creditors who cannot directly obtain the information they need in making decisions about providing resources to the entity and in assessing whether the management and the governing board of that entity have made efficient and effective use of the resources provided? If not, why?

- 1 As stated in our general remarks, we generally agree that the conceptual framework should provide some explanation about what constitutes a reporting entity. However, it should be made clear that the description of a reporting entity within the conceptual framework does not prejudice decisions of national legislative bodies or regulatory authorities as to who should or may report under IFRSs. In our view, it should be left to the individual jurisdiction to decide whether the application of IFRSs is required or allowed for particular entities, even if the resulting financial statements may not entirely fit the concept the IASB has in mind when developing IFRSs.
- 2 Apart from that, we find the description of a reporting entity to be unclear to a certain extent. According to the ED, a reporting entity may include more than one entity (aggregation) or it may be a portion of an entity (disaggregation). But the draft remains vague as to whether a reporting entity may include another or several other reporting entities.
 - In case of a disaggregation: If there is a legal entity consisting of several parts and if each part meets the description of a reporting entity ('circumscribed area', 'information-useful'), are the individual parts as well as the legal entity per se also reporting entities and would both be permitted to prepare financial statements that may carry the label IFRS?
 - In case of an aggregation: If entity A (e.g. an entity under control) is part of a larger entity B (e.g. a group reporting entity) and if both entities meet the description of a reporting entity individually ('circumscribed area', 'information-useful'), are entity A



as well as entity B reporting entities and would both be permitted to prepare financial statements under IFRSs?

- 3 In addition, the ED states in paragraph RE5 that a legal entity has the potential to be a reporting entity but is not per se a reporting entity. A single legal entity that conducts economic activities and does not control any other entity is likely to qualify as a reporting entity. Does this mean that a legal entity that controls another entity (controlling entity) does not qualify as being a reporting entity? In contrast, paragraph RE11 says 'parent-only' financial statements might provide useful information. In our view, the ED does not clearly state whether a controlling entity meets the description of a reporting entity.
- 4 In this context, we believe that all legal entities should qualify as reporting entities, irrespective whether a legal entity represents a controlling entity or not. This does not mean that reporting entities should be limited to business activities that are structured as legal entities, i.e. the question of what constitutes a reporting entity should not refer solely to the legal structure of an entity. The decision usefulness of group financial statements resulting from the aggregation of legal entities whose resources, claims and operations are considerably commingled is out of question. However, different legal structures could well result in dissimilar legal claims (e.g. subordination). Group financial statements do not depict these differences. We consider this information to be relevant as well and, thus, believe that separate financial statements are decision-useful in this regard.
- 5 Furthermore, we think that separate financial statements and consolidated financial statements for subgroups should be treated as independent and autonomous. Accordingly, we view financial information about a legal entity, which is part of a larger reporting entity, as information about a reporting entity, and not as being disaggregated information about the group.



Question 2, part a

Do you agree that if an entity that controls one or more entities prepares financial reports, it should present consolidated financial statements?

- 6 We agree that control is the right basis for consolidation and that consolidated financial statements are appropriate whenever an entity that controls one or more entities prepares financial statements.
- 7 However, we believe that a clear differentiation between
- the decision on who is required to prepare financial statements as well as the decision as to what kind of financial statements are required to be prepared and
 - the scope of consolidation (i.e. to determine which companies are to be consolidated)
- is essential.
- 8 The IASB's mandate does not include defining which entities are required to prepare (consolidated) financial statements. The decision on the entities which are required to prepare (consolidated) financial statements (or may do so voluntarily) rests solely with national legislators or regulatory authorities.
- 9 In our view, the IASB's mandate is to define the scope of consolidation and to prescribe consolidation techniques for entities preparing consolidated financial statements.

Question 2, part b

Do you agree with the definition of control? If not, why not?

- 10 We agree that control should be defined at the conceptual framework level, since we regard the control concept to be fundamental to financial reporting. In principle, we believe that everything that is controlled by a reporting entity should be recognised in the financial statements of the respective entity. Control is a pervasive notion and



includes direct control over one's own assets as well as having control over assets by way of owning interests in another entity. Therefore, control should not be defined in the reporting entity chapter, but rather at a higher, more general level in the conceptual framework.

- 11 As expressed in our comment letter on the discussion paper preceding the ED, we continue to emphasise our position that risk and rewards may serve as indicators of control. In our view, this should be discussed at the conceptual framework level and not solely within the standards on consolidation as currently intended by the IASB.

Question 3

Do you agree that a portion of an entity could qualify as a reporting entity if the economic activities of that portion can be distinguished from the rest of the entity and financial information about that portion of the entity has the potential to be useful in making decisions about providing resources to that portion of the entity? If not, why?

- 12 Yes, we agree that a portion of an entity could qualify as a reporting entity. For a more detailed discussion about disaggregation please refer to our comments on question 1.

Question 4

The IASB and the FASB are working together to develop common standards on consolidation that would apply to all types of entities. Do you agree that completion of the reporting entity concept should not be delayed until those standards have been issued?

- 13 Yes, we agree.



Appendix B: Comments on other types of financial statements

'Parent-only' financial statements

- 14 We appreciate that the conceptual framework affirms that 'parent-only' financial statements can provide decision-useful information. However, as discussed in more detail in paragraph 3 of this comment letter, the ED does not clearly state whether an entity preparing 'parent-only' financial statements meets the description of a reporting entity.
- 15 As stated in paragraph 5, we are supportive of 'parent-only' financial statements that are independent and autonomous of other kinds of financial statements that an entity might (have to) prepare. Thus, we disagree with the requirement that 'parent-only' financial statements must be presented together with consolidated financial statements. Just as we believe that the IASB should refrain from stating which entities are to prepare certain kinds of financial statements, we are equally of the view that the IASB should not conclude on matters of this type of presentation in order not to create conflicts with jurisdictional requirements. We note, for instance, that in the EU several member states, including Germany, provide entities in their jurisdiction with an extra two months period to prepare consolidated financial statements. Holding back the parent-only financial statements just to provide them at the same time as consolidated financial statements (as the ED suggests) creates legal problems in those member states. Rather, and in contrast to the current prescriptive approach of the ED, the IASB should mandate that such financial statements be clearly identified and marked as parent-only.
- 16 We propose that an entity which presents separate financial statements and is itself part of a wider group should disclose this fact in the notes to its separate financial statements as well as the name of the ultimate parent and whether and where the consolidated financial statements of that wider group are available. Appropriate caption and note disclosure should serve to sufficiently protect users with reasonable business knowledge from misunderstanding the substance and nature of the information included.



Combined financial statements

- 17 We do not object to the preparation of combined financial statements provided they are properly marked as being ‘combined’ (instead of, e.g., consolidated). Just as for parent-only financial statements, we believe that an appropriate caption and note disclosure to protect users from misunderstanding the substance and nature of the information in these statements will ensure that they are clearly identified.
- 18 Furthermore, we recommend that the Board remove the reference to entities under common control. Although combined financial statements are often seen in the course of carve-outs and spin-offs, we do not consider the reference to these circumstances necessary to producing combined financial statements. For example, we are aware of combined financial statements being prepared for the entirety of entities in a given sector, such as co-operatives, which are prepared on an ‘as-if’ basis, and we would not object to such financial statements being prepared following IFRSs provided they are clearly marked as being combined.